CBN

Canadian Bank Note
Company, Limited

Trusted
SECURITY SOLUTIONS

Annual Report 2002

Corporate
Profile

Canadian Bank Note Company, Limited is an international company which supplies printed products and related issuing and control systems in four business areas: Lottery Systems, Identification Systems, Payment Systems and Shareholder Services. The Company has extensive manufacturing operations for printing currency, passports, visas, lottery tickets, postage and other related products as well as for producing hardware devices such as passport and card readers and lottery terminals. In addition, the Company has a large complement of software engineers for designing software systems.

Security is an integral part of every product printed and system developed and is a major consideration from the planning and design phase of the product, through to the finished item. Canadian Bank Note's uninterrupted 100 years of manufacturing high-security documents, together with its achievement of ISO 9001 certification, is itself a testament to the Company's unimpeachable standards.

Canadian Bank Note's historically strong commitment to research and development will continue to ensure that, during times of rapid change, every one of its customers benefit from the latest technological advances. This has maintained its leading position in the marketplace and has ensured that Canadian Bank Note keep one step ahead of the counterfeiter.

Products, services and systems are now marketed in more than 40 countries.

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Letter

to Shareholders

Earnings per share in 2002 reached their highest level in nearly a decade as gross profit margins were up sharply for all Divisions. Important new business ventures were successfully undertaken and resulted in the signing of significant multi-year contracts. The sales volume from these contracts, added to that from existing and extended contracts, provides Canadian Bank Note Company, Limited (CBN) with the largest base of continuing business ever going into a new year.

Net earnings in 2002 were $6.5 million ($0.26 per share) as compared to net earnings in 2001 of $2.4 million ($0.10 per share). One third of CBN's pre-tax earnings in 2002 resulted from a pre-tax profit of $3.4 million on the sale of land.

Key to the improvement in net earnings was a further improvement in gross profit margins. Gross profit margins as a percentage of sales were only 30% in 2000 but increased to 33.4% in 2001 and to 36.4% in 2002. The 6.4% improvement in gross profit as a percentage of sales over the last two years accounts for the increase from operations in pre-tax profitability from 2000 to 2002.

While gross profits were up for all four Divisions in 2002, sales were down for all Divisions, on average by 5%. Sales in 2002 were $112.9 million versus $118.7 million in 2001. We were very encouraged that the improved gross profits more than offset the decrease in sales and were enough to give CBN the best net earnings in many years. The drop in sales is explained in part by the quest for higher earnings and in part by trying to maintain the 13.7% increase in sales of the previous year; 8.2% of which was held.

Our profit goal continues to be to provide shareholders with a 20% after tax return on equity (ROSE). The organization is focused on its attainment as our ultimate financial purpose. In 2002, ROSE was 11.4%.

Capital expenditures for the year were $12.3 million compared to $6.7 million in 2001. The major expenditure was for the start-up of a new electronic lottery installation in Honduras that will contribute to results from our Lottery Systems Division in 2003. Also, two new state-of-the-art Heidelberg presses were acquired for our McAra Branch as well as a Super Giori banknote printing press for our Ottawa plant. These presses improve our product offerings, lower our costs and increase our capacity.

Our balance sheet remains strong and we have large unused lines of credit available to cover the growth expected in 2003 and beyond. Even though bank borrowings were up at year-end due to the large volume of shipments in December, for most of the year borrowings were reduced, resulting in interest costs of $0.6 million in 2002 versus $1.6 million in 2001.

Last year, as a result of September 11th, we reported an expected increase in the volume of inquiries and orders for our Identification Systems (ID) Division, which is a market and technological leader on the world stage for positively identifying people crossing borders. These inquiries did occur as budgets were increased. However, many governments put pending orders on hold as they reevaluated the technologies they were ordering to ensure that they were getting the best. Orders are expected to increase for our ID Division.

The most significant order received by CBN to date has been for a new, technologically advanced Permanent Resident Card for Canada, which has the added benefit to CBN that we personalize the cards. Personalization is a new activity for CBN. In 2003, CBN has been successful in obtaining additional multi-year systems contracts, utilizing the same technology. The value of the contracts exceeds $40 million for delivery over the next five years.

These new products were created to meet the increased security requirements necessitated by our high-risk world. Both of these orders resulted in multi-year contracts and were from Canadian customers, reversing a trend to more international orders. Domestic orders accounted for 45.3% of CBN's sales in 2002 up from 41.4% in 2001. The

increased sales from these orders will be recorded in the years ahead. Our base of long-term repeat orders is increasing with each multi-year contract that we sign.

Last year, we advised of an organizational structure change to full divisionalization with the appointment of a senior executive to head up each Division. This change has been successful and affords a better response by each Division to market opportunities. Consequently, the outlook for 2003 is for growth in both sales and profits.

Our business provides solutions to eliminate fraud connected to the issuance of documents or cards. Our work makes the world a safer place in which to live and to do business, which is especially important at a time when the business world has been rocked by large corporate scandals, and the political world plagued by terrorists.

"We say what we mean and we mean what we say."

For anyone who wants to do business with us, it is absolutely essential that they be able to trust us. This trust follows from their opinion of our honesty and integrity, our competence and productivity, our fairness in dealing with them, and their assessment of the rationality of our business process. They must know that we say what we mean and we mean what we say.

For the past 20 years at CBN, we have had a Corporate Code that contains our basic principles and guides us as we make decisions. Given the enormous importance of our character being above reproach as we offer solutions to security problems, it is our intention to even better explain to our employees and to those with whom we deal, the importance to CBN of the principles found in our Code.

Even though our products are continually improved and upgraded by new and better models, the principles that we stand for do not change. They have already stood the test of time and will be appropriate for guiding our actions, no matter what products and business model that we select.

As our annual report is a major communications document for CBN and reaches several audiences, we have prepared a separate, smaller booklet that reaches a more specific audience and elaborates on our time-enduring principles. This booklet can be kept indefinitely. We make it available to you with the 2002 Annual Report, in the hope that you will read it and enjoy it.

Going forward, we will spend much time with our employees to further explain how we believe that the path to profit, success and happiness is through principle. Accordingly, we would like to express our appreciation to our numerous, talented and dedicated employees, many of whom are shareholders, and who are so important to our future success. Also, we would like to thank our advisors, bankers, customers, shareholders and suppliers for their continued and necessary support.

D. R. Arends

Douglas R. Arends
Chairman and
Chief Executive Officer

R G Arends

Ronald G. Arends
President and
Chief Operating Officer

Values

at Canadian Bank Note Company, Limited

Canadian Bank Note Company, Limited has always held steadfast to the values expressed in its Corporate Code. Reason, Justice, Productivity, Honesty, Integrity, Independence and Pride are all at the core of our philosophy and function as a practical guiding principle for our workforce.

The above values encourage our employees to be objective and realistic, to open their minds to new developments and progress, to excel in their trades and professions and, most importantly, to have a deep sense of pride in their work and the company they work for.

Canadian Bank Note is fortunate to employ a wide range of disciplines from pressman to software engineers, and aims to hire the best in their respective fields. During the hiring process, an individual's character is of the uppermost importance. The combination of a skilled workforce and strong values encourages growth and prosperity and our customers benefit from the excellent workmanship represented in our products. Everyone wins!

Our philosophy is not new. Our philosophy is timeless and it is here to stay. Even in a world of wavering values, CBN will continue to observe these principles.

In conjunction with the 2002 Annual Report, a booklet has been prepared, which outlines Canadian Bank Note's philosophy. It is available to you, free of charge.

Please refer to page 40 for information on how to request a copy of the booklet from Judy Lonsdale, Director of Corporate Communications at 613-722-3421 or by e-mail at jlonsdale@cbnco.com.

Operations
Review 2002

Canadian Bank Note's printing operations consist of high-security printing accomplished in our main plant in Ottawa, high-quality commercial printing performed in our McAra plant in Calgary, and lottery ticket printing conducted in our factory in Tampa, Florida. Our Financial Printing operations are undertaken in a modern downtown facility in Toronto.

Printing operations accounted for 60% of CBN's total sales in 2002, up from 56% in 2001. The production of hardware and the design of software products make up the balance of CBN's operations.

Hardware manufacturing, comprised mainly of travel document readers, lottery terminals and connection boxes for point-of-sale devices, is located in Ottawa at CBN's Auriga Drive facility. Software engineering, new product development, and product design are accomplished at two of our Ottawa facilities located on Lady Ellen Place and Auriga Drive.

Facilities for sales and administration are located in Ottawa, Toronto, Tampa (Florida), Calgary, Montreal, London (England), Prague, Bucharest, Guyana, Honduras and Suriname.

A process of continuous improvement was undertaken in all plants during 2002 to improve gross profit margins by lowering costs through improved productivity. In addition, we expanded our capabilities and capacities to produce more volume of existing products and new products including polycarbonate cards.

The initiatives that arose out of the September 11th attack are changing the mix of our business and our marketing emphasis away from developing countries towards countries such as Canada and the United States. These countries have the commitment and funds to put in place the measures that will make another similar attack much more difficult. As a result, international orders accounted for only 54.7% of our business in 2002 as compared to 58.6% in 2001.

Total sales for all Divisions in 2002 were 5% less than last year, $112.9 million versus $118.7 million in 2001, although on average they were 8.2% higher than in 2000. Generally, the lower sales volume was not due to lost orders but rather to timing issues associated with finalizing orders and getting them shipped before the end of the year. With 32% of sales coming in the fourth quarter and only 21% in the first quarter, planning production and forecasting sales was more difficult than usual.

Our profit budget was met in spite of the lower sales, as gross profit percentages exceeded expectations. Gross profit margins were up an average of 3%, which when added to the 3.4% improvement in 2001, resulted in a 6.4% improvement in gross profit margins since 2000, i.e., a 31.3% increase in gross profit dollars available for profits and to cover overheads. Net earnings were $6.5 million versus net earnings of $2.4 million in 2001, the largest net earnings since the $15.1 million achieved in 1993.

We sold approximately 7 acres of our 14-acre site on Richmond Road in Ottawa. Emotionally, this was a difficult decision as we have owned the property for more than 50 years. However, as the property was surplus to our needs and real estate values were up, we chose this opportunity to realize a $3.4 million pre-tax profit. Total pre-tax profit in 2002 was $10.2 million compared to $4.9 million in 2001.

Selling, general and administrative (SG&A) costs in 2002 rose 6.7% absolutely and 2.7% as a percentage of sales. In 2003, we are budgeting for the first significant drop in a decade in SG&A costs as a percentage of sales. When it occurs, it will

provide support to the rationale for the overhead spending that has occurred in the last few years. The markets that we faced during the 1990's changed and we needed to develop new products, differentiate ourselves from our competition and expand internationally. This expansion was expensive and added overheads in advance of sales.

In the early 1990's, one of the business areas that interested CBN was the provision of complete secure solutions for tracking travellers. We took on this challenge by adding travel document readers, as well as issuing and border control software to our product line of passports, in order to provide more complete solutions to our customers' problems. Today, we are a market leader in a business that has benefited from an increased willingness by governments to pay to catch terrorists and stop the perpetration of fraud. The ID Division, created to develop documents and systems for travellers, has introduced exciting state-of-the-art technologies for related products.

"Our profit budget was met in spite of the lower sales, as gross profit percentages exceeded expectations."

Early in 2002, Citizenship and Immigration Canada awarded CBN a contract to supply and personalize a new Canadian Permanent Resident Card requiring the start-up in mid-year in our Ottawa plant of a high-tech production facility. This clean-room operation employs the latest polycarbonate card, laser-engraving technology including an iris scan security system for entry.

Polycarbonate card technology has other applications and we have in 2003 received another order for this technology in the form of a card that we will personalize as well. This multi-year order is valued at over $40 million for delivery over the next five years. Plans are currently underway to expand the card manufacturing facility in our Ottawa plant.

We were very pleased to be awarded a long-term contract to run an electronic lottery in Honduras that commenced in the second half of 2002. Due to the 6-million population base in Honduras, there is the potential for even greater revenue than from our former business in Jamaica. The installation and launch were successful, although about 20% more costly than anticipated. A new Daily Numbers game has been added to the Lotto games and management is optimistic that operations in Honduras will add significantly to our Lottery cash flow in 2003.

Capital expenditures were $12.3 million in 2002 as compared to depreciation and amortization of $5.7 million. In 2001, capital expenditures were $6.7 million and in 2003 capital expenditures are expected to be $12 million. In addition to the lottery installation in Honduras just described, the major capital items added were two new high-quality Heidelberg commercial printing presses at McAra Printing in Calgary and a Super Giori banknote printing press in our Ottawa plant. McAra has been a steady contributor of profit for many years, although in recent years it has had to face some very difficult market conditions. The new presses, which are busy and running well, were added to improve profit margins by lowering direct costs and increasing capacity. The Super Giori press is the world standard for banknote printing and will be used to print most of our Canadian banknotes, as well as some of our orders for other countries. The first order printed on this press, commencing in May 2003, was for $5 Canadian banknotes.

Innovative

Lottery Systems

The major products sold by the Lottery Systems Division are instant lottery tickets and lottery systems. Lottery systems comprise the sale of Daily Numbers and Lotto games from electronic terminals. The Lottery Systems Division accounted for approximately 22% of CBN total sales in 2002, the same percentage as in 2001.

Sales for the Lottery Systems Division were $25.4 million, down $1.2 million (4.4%) from 2001. Gross profit percentage increased from 30.3% to 32.6%, mitigating the drop in gross profit dollars year over year to $0.2 million.

Sales from instant tickets increased while system sales were down, due to the loss of revenue from Jamaica. In addition, no sales were recorded for validation terminals in 2002, as was done in 2001 when a large quantity of terminals were sold to the Atlantic Lottery Corporation. Increased system sales occurred from existing customers in the Caribbean and Latin America who offer Lotto and Daily Numbers games.

"...we are in the process of developing a new on-line lottery system using the latest web technology."

In May 2002, we launched a new on-line lottery in Honduras that utilizes 500 wireless terminals. This lottery is operated by CBN under a long-term contract. The population in Honduras is 6 million, which makes it the largest country that we currently serve. The combination of a relatively large population base and the opportunity for CBN to run the complete lottery operation has buoyed our enthusiasm with the prospects for success in Honduras.

For over 20 years, the Lottery Systems Division has been offering solutions to its customers that best suit the circumstances of the country in which the lottery is conducted. To be able to continue to offer our customers the latest and best technology, we are in the process of developing a new on-line lottery system using the latest web technology. We expect to deploy this system during 2003.

A long-term licensing agreement was entered into between CBN and the Ontario Lottery and Gaming Commission (OLGC) to allow CBN to use OLGC software to combine the sales of many bingo halls to afford bingo players the chance to win much higher prizes than could be won by the players in a single bingo hall. Bingo is a popular game in many countries and we expect that this technology will lead to contracts that produce a steady stream of income. We anticipate signing an agreement with our first customer in Europe during 2003.

The Florida plant met its cost performance and quality goals in 2002 for printing instant lottery tickets. This makes it a competitive lottery ticket printing plant able to supply the instant ticket requirements to a wide cross-section of existing and potential customers. However, orders were insufficient in 2002 to fill the unused capacity. Gross profit figures, although much better than in 2001, were still below expectations. The organization remains focused on securing the necessary profitable orders.

Contract extensions were secured for the supply of instant tickets from Connecticut and New Hampshire and secondary supplier positions were landed with New Jersey, Kansas and Arizona. Also, for the first time, a large instant ticket order was awarded to us from the Philippines.

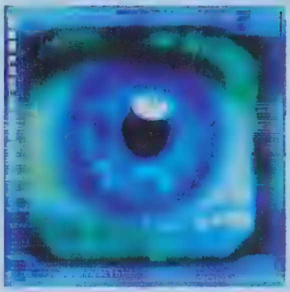
Patents are pending for a novel new instant ticket game developed by our staff in Florida. This progressive play type of game, designed to create exciting player interest in a familiar game such as blackjack, was launched as a $30 ticket in Connecticut. Based on initial success, Connecticut plans to release a second game and other states are working with us to prepare similar games. Two experienced marketing executives have been added to our sales staff to assist in securing additional orders for this new game, as well as for our existing product offerings.

After a few years of falling sales, the Lottery Systems Division expects a substantial increase in both sales and gross profits in 2003.

Leading Edge

ID Systems

The major products sold by the Identification Systems Division are passports and travel document readers, visas and ID cards and software systems for issuing, tracking and controlling these high-security documents. Identification Systems accounted for approximately 40% of CBN total sales in 2002, the same percentage as in 2001, once again making it the largest CBN Division.



Sales were $45.2 million in 2002, down 3.5% from the $46.9 million achieved in 2001. However, improvements in gross profit more than compensated for any decrease in sales, as total gross profit was 1% higher than in 2001. The increase in gross profit occurred because the gross profit percentage of sales increased from 40.1% of sales in 2001 to 42.1% of sales in 2002.

The major accomplishment for the Identification Systems Division in 2002 was securing an order for the new Canadian Permanent Resident Card and then successfully establishing the required high-tech production facility that delivered personalized cards on time and on budget. Personalizing the cards and delivering them is a new and attractive business for CBN, as it is a high value-added activity.

The Permanent Resident Card utilizes new technology. The card is a laminate of several layers of a polycarbonate material and has an optical stripe for storage and retrieval of large amounts of data, as well as traditional high-security printing features found in banknotes. This card has already won two awards from the International Card Manufacturer's Association (ICMA) for technical excellence in the "best design" and "best security" categories. Many regard this card as the most secure card available anywhere in the world.

The production of Canadian passports continues to be the flagship account for CBN's passport business. A five-year renewal contract was signed in 2002 with the Canadian Passport Office for the supply of newly designed digital passports. Deliveries of digital passports have already been made. The sale of international passports was up sharply with significant orders produced in 2002 for Bolivia, Ecuador, Jamaica, Mali, New Zealand and Yemen. We also began development of software systems for Ecuador, Maldives and Mali as well as for upgrading the Azerbaijan system. Demand for both Canadian and international passports and systems for delivery in 2003 is brisk and is expected to surpass 2002.

At the Interpol Conference on Fraudulent Travel Documents and Systems held in Amsterdam, we launched our "Smart" passport, which incorporates a radio frequency IC chip, our Vanguard Border Control unit and our secure e-visa system. Considerable interest was expressed in these offerings. The chip adds to the cost of the passport and potential users have to balance the extra costs versus the benefits. Governments are generally willing to spend more for improved security.

Sales of travel document readers in the year were encouraging, even though a large order in 2001 for Saudi Arabia did not repeat. In 2002, we sold to 15 different passport-issuing authorities located around the world. Especially encouraging was the sale of significant quantities of readers to the US Government, which recognized the technical advantages of our reader. Our latest model of travel document reader is in the final stage of completion and, with its many new advanced features, is expected to generate substantial interest and sales. Canadian Bank Note's readers are now used successfully in 40 countries and travel document readers should continue to be an attractive market segment for CBN.

Two new secure turnkey systems were developed for the Government of Canada; one for the issuance of machine-readable Marine Certificates of Competency in the form of a passport booklet for Transport Canada, and the other for a system utilized by Citizenship and Immigration Canada to issue a new secure citizenship document. We are also in the process of completing an issuing system for ID cards in Togo.

During 2002, we secured a multi-year extension and expansion of our contract in Romania for issuing vehicle registrations and drivers' licenses. We value highly our relationship with the Government of Romania, which began more than 10 years ago.

We continue our Research and Development efforts in biometrics with an aim to offer our customers whatever features suit their application. The three major biometrics offered are facial recognition, iris recognition and fingerprint reading. During the year, we participated in the successful automated passenger authentication project at London's Heathrow Airport in the UK, which involved the use of iris recognition technology.

The forecast for the Identification Systems Division in 2003 is for significant growth in sales and gross profits.

Secure

Payment Systems

The major products sold by the Payment Systems Division are banknotes, postage stamps, fiscal and tax stamps, travellers' cheques, bonus coupons, gift certificates and connection boxes for point-of-sale terminals. These products accounted for approximately 20% of CBN's sales in 2002, the same percentage as in 2001.

Sales for the Payment Systems Division were $24.0 million, down from $26.0 million in 2001. This 8% decrease in sales was offset by an 17% improvement in gross profit, as gross profit margins as a percentage of sales, improved from 21.9% in 2001 to 27.6% in 2002.

Demand from the Bank of Canada for the printing of Canadian banknotes rose 4% in 2002 and, in 2003, orders for the printing of Canadian banknotes are expected to increase by an additional 50%. We were very encouraged by the use of CBN by the Bank of Canada for a number of special projects and services, such as leading the design team for the new Canadian $5 banknote that was introduced in 2002. Over the last few years, we have consciously put competent staff in place to enable us to better serve the needs of our major customers, such as the Bank of Canada. It is rewarding to benefit from the increased requirement by the Bank for these services.

"...in 2003, orders for the printing of Canadian banknotes are expected to increase by an additional 50%."

Banknotes are designed so as to make it difficult for counterfeiters to print. Complex designs mean that initial runs of a new series of banknotes often result in significant spoilage. The new $10 Canadian banknotes, first printed in 2001, were no exception but we are pleased to report that in 2002 the costs of printing the $10 banknotes met our standards. Also, better than expected results were achieved from printing a new order of banknotes for Honduras and we delivered successfully our first order of banknotes to Nepal.

Over the past three years, we have upgraded our capability to print banknotes by the addition of a Giori Super Simultan press in 2001 to do offset printing, and the addition of a Super Giori press in 2002 to do intaglio printing. In 2003, we expect that virtually all of our banknotes, including Canadian banknotes, will be printed on these two presses and that the presses will be fully occupied to the end of the year.

For some time, CBN has been changing its production processes in preparation for the printing of banknotes on a polymer substrate. Small printing orders have been received and successfully completed including the printing of the 5-Pound banknote for the Bank of Northern Ireland and the 2 Kina banknote for Papua New Guinea. In 2003, we were awarded a larger order for printing polymer banknotes for Zambia.

Although we secured the order to print Canadian Christmas postage this year, total orders for the printing of Canadian postage stamps were less than expected in 2002 and profit margins were difficult to maintain. Pressure sensitive fiscal stamps were designed and successfully delivered to two state governments in Latin America.

Orders for the printing of travellers' cheques were down from the previous year, likely related to the general reluctance of people to travel due to security and health concerns. We are proud to have expedited deliveries for Travelex and to have assisted them in securing the American Automobile Association order for travellers' cheques.

Canadian Bank Note has enjoyed a long-term, valuable relationship with Canadian Tire Corporation, which has resulted in CBN printing the very popular bonus coupons, Canadian Tire money. Last year we successfully printed this order again and, as a result, have been awarded a long-term sole supplier contract.

In 2003, the Payment Systems Division is expecting its best results in some years as both sales and gross profits rise due to increased orders for banknotes.

High Quality

Shareholder Services

The major products sold by the Shareholder Services Division are financial printing (mainly prospectuses), stocks and bonds, and high-quality commercial printing. The Shareholder Services Division accounted for approximately 16% of total sales in 2002, the same percentage as in 2001.

Sales for the Shareholder Services Division were $18.3 million, down from $19.2 million in 2002, a 5.0% decrease. However, as with the other Divisions, any decline in sales was offset by a 1% improvement in gross profit dollars, as gross profit margin as a percentage of sales, increased from 36.7% in 2001 to 39.1% in 2002.

2002 was an acceptable year for McAra Printing given the uncertainty created in the oil patch by the signing of the Kyoto Accord and the poor equity markets, which reduced overall spending on printing in Calgary. McAra managed to record only a small drop in sales and profits by targeting the sale of high value-added marketing materials to other than oil patch companies and producing documents, as well as security passes, for the thousands of staff and delegates who attended the G8 summit in Kananaskis, Alberta in June 2002. Our unique blend of technology and trained staff allowed McAra Printing to mitigate the negative market effects.

"In 2003, the Shareholder Services Division expects growth in both sales and gross profits."

Three years ago, a new state-of-the-art Heidelberg 6-colour printing press was acquired for McAra Printing. Management successfully introduced this new press and, consequently, we approved the acquisition of two additional, complementary, Heidelberg presses for installation at McAra in the fall of 2002. These presses have performed in line with expectations and have reduced McAra's costs and increased its capacity. In keeping with these improvements, the forecast is for increased sales and profits at McAra in 2003.

Stock market values remained at bearish levels throughout the year as a result of troubled world conditions and low productivity. These poor equity markets created difficult times for our Financial Printing Group in Toronto. However, our skilled team of experts still managed to achieve gross profit levels in 2002 equal to 2001.

Our close association with R.R. Donnelley & Sons, the large US-based financial printer, continued for financial printing. We support each other on cross-border issues, where appropriate.

The market for the sale of printed stock certificates and bonds has been on the decline for many years, as this market segment, which was once one of our largest segments, has fallen to be one of our smallest. Nevertheless, sales and margins for stocks and bonds showed favourable, year over year increases achieved by our Calgary, Montreal, London (UK) and Toronto staff.

In 2003, the Shareholder Services Division expects growth in both sales and gross profits.

Financial
Review

Management's Discussion And Analysis

Overview

The Company was once again profitable in 2002, recording net earnings of $6.5 million on sales of $112.9 million compared to earnings of $2.4 million on sales of $118.7 million in 2001.

Although sales decreased by $5.8 million or 4.9%, gross profit increased by $1.5 million and gross profit percentage improved to 36.4% in 2002 from 33.4% in 2001. The Company's expenses decreased by $0.4 million in 2002 with a $0.9 million decrease in interest and a decrease of $1.2 million in amortization and depreciation partially offset by an increase in selling, general and administrative expenses of $1.8 million.

In the fourth quarter of 2002, the Company realized a pre-tax gain of $3.4 million or $2.1 million after tax on the sale of surplus land adjacent to its Ottawa manufacturing facility.

Sales

The Company experienced a decline in sales in its four business units in 2002. Identification Systems sales and Lottery Systems sales declined by $1.7 million and $1.2 million respectively, while the sales decline in Payment Systems and Shareholder Services were $2.0 million and $1.0 million.

The decline in Identification Systems sales is due to timing. The Identification business has a strong order backlog, which is expected to come on line commencing in the second quarter of 2003. During the year, the Company continued to produce passports, visas and other identification documents for new, as well as ongoing, customers. A number of issuing systems were installed or upgraded in 2002. The Company's travel document readers were sold to 15 different countries in 2002 bringing the number of countries employing the Company's readers to 43.

As expected, Lottery Systems revenues were down year over year as a result of the ending of the Jamaica contract in the third quarter of 2001. In 2002, the Company commenced operations of the Honduras lottery, its largest lottery systems installation to date. The full effect of the Honduras lottery on the Company's business will be known commencing in the second quarter of 2003.

Payment Systems also have a significant order backlog, which are expected to be shipped commencing in the second quarter of 2003. In 2002, the Company produced banknotes for Canada and two other countries. In addition, postage stamps, travellers' cheques and other payment documents were produced for a number of authorities. The Company significantly improved its banknote production capabilities through the acquisitions by lease in 2001 of a Giori Super Simultan press and the purchase of a Super Giori banknote printing press in 2002.

McAra Printing sales were comparable to 2001 and its manufacturing capability was enhanced through the acquisition of two new multi-colour presses in 2002. Weak financial markets affected the financial printing sales in the last quarter of 2002.

Cost of Sales

The Company's gross profit increased by $1.5 million to $41.1 million. Gross profit percentage was 36.4% in 2002 compared to 33.4% in 2001. Each business unit showed an improvement in gross profit percentage.

Gross profit percentage in the Lottery Systems business was 32.6% compared to 30.3% in 2001. Lottery results were favourably affected by improved margins in ticket manufacturing as a result of the relocation of our ticket manufacturing facility in the second quarter of 2001. Gross profit percentage improved 2.0% to 42.1% in Identification Systems and 5.7 % to

27.6% in Payment Systems. Improved efficiency in the Ottawa manufacturing facility resulted in the improvement in gross profits in Identification Systems and Payment Systems. Year over year Shareholder Services gross profit was comparable while gross profit percentage improved to 39.1% from 36.7%.

Expenses

Interest expense was $0.9 million less in 2002 as a result of improved collection of accounts receivable throughout the year and lower interest rates. Selling, general and administrative expenses increased by $1.8 million as a result of increased marketing initiatives. In 2002, depreciation and amortization amounted to $5.7 million compared to $6.9 million in 2001.

Liquidity

At December 28, 2002, working capital was $21.8 million compared to $18.5 million at December 29, 2001.

In 2002, the Company generated $11.5 million in operating cash of which $8.3 million was invested in working capital represented mainly by a temporary increase in accounts receivable. In addition to operating cash, the Company generated $4.2 million from the sale of assets surplus to its requirements. The Company also invested $12.3 million in capital assets, most of which was for manufacturing equipment and start-up costs for the new lottery in Honduras.

Change in Accounting Policy

In 2002, the Company adopted the accounting standard contained in the CICA Handbook, Section 3062, *Goodwill and Other Intangible Assets.* Section 3062 became effective January 1, 2002 and requires that goodwill be tested for impairment as of the beginning of the fiscal year in which the Section is initially applied. To the extent that the carrying amount of a business unit, including goodwill allocated to it, is greater than the fair value of the business unit, an impairment loss exists. Any impairment loss on the introduction of Section 3062 is considered transitional and is recognized as an effect of change in accounting policy and is charged to opening deficit in the year of its adoption.

The Company determined that goodwill in Lottery Systems was impaired at the date of adoption in the amount of $3.4 million. This amount was charged to opening retained deficit in accordance with the transitional provisions of Section 3062. As a result of no longer amortizing goodwill pursuant to Section 3062, net earnings increased by $0.2 million or $0.01 per share.

Management Report

The accompanying consolidated financial statements and all information in this annual report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies outlined in the notes to consolidated financial statements. Due to the nature of the Company's operations, certain estimates are necessary in the preparation of such statements. In the opinion of management, the consolidated financial statements have been prepared within reasonable limits of materiality and are in accordance with Canadian generally accepted accounting principles. The financial information contained elsewhere in this report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management maintains systems of internal control which are designed to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of consolidated financial statements.

The board of directors carries out its responsibility for the consolidated financial statements in this annual report principally through its audit committee, consisting of a majority of outside directors. The audit committee reviews the Company's annual consolidated financial statements and other information in the annual report, and recommends their approval by the board of directors. The shareholders' auditors have free and independent access to the audit committee.

KPMG LLP, an independent firm of Chartered Accountants, has been engaged, as approved by a vote of the shareholders at the Company's most recent annual general meeting, to examine the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion. Their report follows.

RG Arends

Ronald G. Arends
President and Chief Operating Officer

Lavoie

Charles R. Lavoie
Executive Vice President and Chief Financial Officer

February 21, 2003

Selected
Quarterly Financial Information

	2001				2002			
	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4
Net Sales	30,723	32,748	28,066	27,181	23,803	26,448	27,103	35,579
Net earnings	826	1,322	184	57	744	411	1,396	3,970
Weighted average number of shares (thousands)	24,760	24,760	24,760	24,760	24,760	24,760	24,760	24,760
Earnings per share	$ 0.033	$ 0.053	$ 0.007	$ 0.002	$ 0.030	$ 0.017	$ 0.056	$ 0.160
Closing share price	$ 2.48	$ 2.06	$ 2.03	$ 2.04	$ 2.65	$ 2.55	$ 1.90	$ 1.75
Closing USA/ Canadian exchange rate	1.5765	1.5244	1.5780	1.5925	1.5950	1.5050	1.5872	1.5776

Five Year
Review

	1998	1999	2000	2001	2002
Net Sales	101,638	103,977	104,372	118,718	112,933
Gross Profit	35,978	35,054	31,315	39,600	41,128
Selling, general and administrative expenses	23,732	23,945	24,258	26,150	27,914
Depreciation and amortization	9,869	9,138	6,674	6,953	5,718
Interest expense	981	1,052	1,064	1,558	630
Gain on sale of land	-	-	-	-	(3,377)
Restructuring charges	-	6,372	-	-	-
Pension surplus distribution	-	(7,900)	-	-	-
Earnings (loss) before income taxes and amortization of goodwill	1,396	2,447	(681)	4,939	10,243
Earnings (loss) before amortization of goodwill	1,633	(1,744)	(255)	2,749	6,521
Net earnings (loss)	1,434	(1,943)	(638)	2,389	6,521
Earnings (loss) per share	0.06	(0.08)	(0.03)	0.10	0.26
Cash provided by (used in) operations after changes in non-cash working capital	9,004	16,873	(8,023)	15,290	3,156
Capital assets, product development and start-up expenditures	5,288	4,096	6,229	6,652	12,347
Working Capital	12,334	17,050	17,795	18,501	21,759

Auditors'

Report to the Shareholders

We have audited the consolidated balance sheets of Canadian Bank Note Company, Limited as at December 28, 2002 and December 29, 2001 and the consolidated statements of earnings and deficit and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 28, 2002 and December 29, 2001 and the results of its operations and its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Ottawa, Canada
February 21, 2003

Consolidated
Balance Sheets

December 28, 2002, with comparative figures for 2001 (In thousands of Canadian dollars)

	2002	2001
Assets		
Current assets:		
Cash and cash equivalents	$ 3,272	$ 1,651
Accounts receivable (note 4)	31,102	18,974
Current portion of long-term receivables (note 5)	101	440
Inventories	14,806	17,946
Prepaid expenses	707	724
Current portion of other assets (note 7)	1,990	–
Income taxes recoverable	–	1,300
	51,978	41,035
Long-term receivables (note 5)	492	561
Investments	164	164
Property, plant and equipment (note 6)	30,546	28,473
Other assets (note 7)	17,612	19,771
	$ 100,792	$ 90,004
Liabilities and Shareholders' Equity		
Current liabilities:		
Operating line-of-credit (note 8)	$ 10,619	$ 1,112
Accounts payable and accrued liabilities	15,872	15,503
Customer deposits	1,330	2,662
Current portion of obligations under capital lease (note 9)	47	47
Current portion of long-term debt (note 10)	2,351	3,210
	30,219	22,534
Obligations under capital lease (note 9)	134	196
Long-term debt (note 10)	6,292	8,369
Employee retirement benefit obligations (note 11)	5,428	3,285
Shareholders' equity:		
Share capital (note 13)	65,453	65,453
Contributed surplus (note 13)	529	529
Deficit	(7,263)	(10,362)
	58,719	55,620
Contingent liabilities and commitments (notes 17 and 18)		
	$ 100,792	$ 90,004

See accompanying notes to consolidated financial statements.

On behalf of the Board:

D.R. Arends, Director

J. G. Levin, Director

Consolidated
Statements of Earnings and Deficit

Year ended December 28, 2002, with comparative figures for 2001 (In thousands of Canadian dollars except per share amounts)

	2002	2001
Net sales	$ 112,933	$ 118,718
Cost of sales	71,805	79,118
Gross profit	41,128	39,600
Selling, general and administrative expenses (note 14)	27,914	26,150
Depreciation of property, plant and equipment	4,694	5,224
Amortization of deferred product development costs	555	562
Amortization of deferred start-up costs	469	1,167
Interest expense (note 10)	630	1,558
Gain on sale of land	(3,377)	–
Earnings before income taxes and amortization of goodwill	10,243	4,939
Income taxes (note 15)	3,722	2,190
Earnings before amortization of goodwill	6,521	2,749
Amortization of goodwill	–	360
Net earnings	6,521	2,389
Deficit, beginning of year	(10,362)	(12,751)
Transitional impairment loss (note 2)	(3,422)	–
Deficit, end of year	$ (7,263)	$ (10,362)
Earnings per share (note 16):		
Basic before amortization of goodwill	$ 0.26	$ 0.11
Basic after amortization of goodwill	0.26	0.10
Diluted	0.26	0.10
Weighted average number of common shares (000's)	24,760	24,760

See accompanying notes to consolidated financial statements.

Consolidated
Statements of Cash Flow

Year ended December 28, 2002, with comparative figures for 2001 (In thousands of Canadian dollars)

	2002	2001
Cash flow from operating activities:		
Net earnings	$ 6,521	$ 2,389
Items not involving cash:		
Depreciation of property, plant and equipment	4,694	5,224
Amortization of product development costs	555	562
Amortization of deferred start-up costs	469	1,167
Amortization of goodwill	–	360
Gain on sale of land and equipment	(3,377)	–
Employee retirement benefit plans expense (income)	1,223	(158)
Future income tax expense	2,166	–
Investment tax credits	(800)	–
Cash flow from operations (note 20)	11,451	9,544
Changes in non-cash operating working capital	(8,295)	5,746
	3,156	15,290
Cash flow from investing activities:		
Additions to property, plant and equipment	(7,624)	(5,477)
Investment in product development	(915)	(430)
Investment in deferred start-up	(3,808)	(745)
Proceeds on sale of property, plant and equipment	4,234	–
Business acquisition, net of cash acquired (note 3)	–	(235)
	(8,113)	(6,887)
Cash flow from financing activities:		
Increase (decrease) in bank indebtedness	9,507	(7,185)
Principal payments on long-term debt	(2,936)	(1,633)
Repayments of obligations under capital lease	(62)	–
Decrease in long-term receivables	69	1,238
Redemption of common shares	–	(4)
	6,578	(7,584)
Increase in cash and cash equivalents	1,621	819
Cash and cash equivalents, beginning of year	1,651	832
Cash and cash equivalents, end of year	$ 3,272	$ 1,651

The Company considers cash equivalents to be highly liquid investments with original maturities of three months or less.

See accompanying notes to consolidated financial statements.

Years ended December 28, 2002 and December 29, 2001 (In thousands of Canadian dollars)

Canadian Bank Note Company, Limited supplies printed products and related issuing and control systems in four business areas; Lottery, Identification, Payment and Shareholder Services. The Company has extensive manufacturing operations for printing currency, passports, visas, lottery tickets, postage and other related products as well as for producing hardware devices such as passport and card readers and lottery terminals. In addition, the Company has a large complement of software engineers for designing software systems. Products, services and systems are now marketed in more than forty countries. Canadian Bank Note Company, Limited is incorporated under the Business Corporations Act (Ontario).

1. Significant accounting policies:

(a) Basis of presentation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. The Company's significant, wholly-owned, subsidiaries include Guyana Lottery Corporation, Creative Games International, Inc., Suriname Lottery Corporation, CBN Gaming Systems Inc. and Loterias Electronicas de Honduras, S.A. de C.V.

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Significant areas requiring management estimates include assumptions used in determining the expense for employee future benefits (note 11) and the valuation and assessment of the recoverability of future tax assets and deferred product development and start-up costs (note 7).

(b) Inventories:

Inventories are valued at the lower of cost and net realizable value.

(c) Investments:

Investments in companies in which the Company has significant influence are accounted for by the equity method.

(d) Property, plant and equipment:

Property, plant and equipment are stated at cost. Property, plant and equipment under capital leases are stated at the present value of minimum lease payments. Depreciation is calculated on a straight-line basis using the following annual rates:

	Rate
Buildings	40 years
Machinery and equipment	3 to 10 years
Leasehold improvements	5 to 10 years

(e) Leases:

Leases are classified as either capital or operating in nature. Capital leases are those which substantially transfer the benefits and risks of ownership to the lessee. Assets acquired under capital leases are depreciated at the same rates as those described in note 1(d). Obligations recorded under capital leases are reduced by the principal portion of lease payments. The imputed interest portion of lease payments is charged to expense.

(f) Product development costs:

Product development costs are related to specific projects that in the Company's view represent a future economic benefit.

These costs are being amortized on a straight-line basis over five years commencing in the year following their incurrence. The net book value of product development costs would be written down if the value were permanently impaired. The Company assesses impairment by determining whether the unamortized balance can be recovered through undiscounted future cash flows to be derived from the project.

(g) Deferred start-up costs:

Deferred start-up costs relate to the costs involved in starting up lottery and other operations.

These costs are being amortized on a straight-line basis over the shorter of five years and the length of the contract to provide services from the commencement of commercial operations. The net book value of deferred start-up costs would be written down if the value were permanently impaired. The Company assesses impairment by determining whether the unamortized balance can be recovered through undiscounted future cash flows to be derived from the lottery.

(h) Revenue recognition:

Revenue from printed products and hardware sales is recognized when the goods are shipped or placed in secure storage at the customer's request.

Revenue from lottery systems that is dependent on gross lottery sales at the lottery site is recognized as lottery draws occur or tickets are sold.

Revenue from lottery sites that are owned or managed by the Company are net of costs directly related to retail sales.

Revenue from a turnkey system provided by the Company on a long-term contract that is dependent upon the number of documents issued by the system is recognized as the documents are issued to the consumer.

Revenue from identification systems provided by the Company under fixed price contracts is recognized using the percentage of completion method based on the ratio of direct labour hours incurred to date to expected total direct labour hours for the contract.

(i) Employee future benefits:

The Company has defined benefit pension plans covering substantially all of its employees. The benefits are based on years of service and the average of an employee's highest 5 consecutive years of compensation. The cost of this program is being funded currently. These plans also have defined contribution provisions.

The Company also sponsors defined benefit life insurance and health care plans for substantially all retirees and employees.

The Company accrues its obligations under employee benefit plans as the employees render the services necessary to earn the pension and other employee future benefits. The Company has adopted the following policies:

- The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages and expected health care costs.
- Assets are valued at fair value for the purpose of calculating expected return on plan assets.

- Any excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of the plan assets is amortized over the average remaining service period of active employees, which for the pension plan is 14.9 years (2001 – 14.9 years) for both the pension plan and the other retirement benefits plan.
- When a restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

(j) Translation of foreign currencies:

The Company's foreign operations are classified as integrated and are translated using the temporal method. Under this method, monetary assets and liabilities are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at exchange rates in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains or losses are included in income. The Company's own foreign denominated transactions and balances are accorded similar treatment.

(k) Derivative financial instruments:

The Company is party to certain forward foreign exchange contracts which are used to manage foreign currency exposures on export sales. These instruments are not recognized in the consolidated financial statements on inception. Gains and losses on forward foreign exchange contracts are recognized in revenues in the same period as the foreign currency revenues to which they relate.

(l) Income taxes:

In accordance with the recommendations of CICA Handbook Section 3465, Accounting for Income Taxes, the liability method of tax allocation is used in accounting for income taxes. Under this method, future tax benefits and obligations are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when differences are expected to reverse. Future tax assets, if any, are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized.

(m) Earnings per share:

Basic earnings per share are computed by dividing net earnings by the weighted average shares outstanding during the reporting period. Diluted earnings per share are computed similar to basic earnings per share except that the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options were exercised and that the proceeds were used to acquire shares of common stock at the average market price during the reporting period.

2. Change in accounting policy:

In September 2001, the CICA issued Handbook Sections 1581 "Business Combinations" and 3062 "Goodwill and Other Intangible Assets." The new standards mandate the purchase method of accounting for business combinations and require that goodwill no longer be amortized but tested for impairment at least annually. The Company has adopted Sections 1581 and 3062 effective December 30, 2001. As of the date of adoption, the Company had unamortized goodwill in the amount of $3,422, which is no longer being amortized. In accordance with the requirements of Section 3062, this change in accounting policy is not applied retroactively and the amounts presented for prior periods have not been restated for this change.

Section 3062 requires that goodwill be tested for impairment as of the beginning of the fiscal year in which the Section is initially applied. The impairment test is carried out in two steps. In the first step, goodwill is assigned to reporting units and the carrying amount of the reporting unit is compared with its fair value. When the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is not necessary. To the extent a reporting unit's carrying amount exceeds its fair value, the Company must perform a second step to measure the amount of the impairment in a manner similar to a purchase price allocation. This second step was to be completed no later than December 28, 2002. Any transitional impairment is recognized as an effect of a change in accounting policy and is charged to opening deficit as of December 30, 2001.

The Company determined as of the date of adoption that it has six reporting units. The Company allocated all assets (including goodwill) and liabilities to these reporting units, and conducted the first step of the transitional goodwill impairment test as of the date of adoption the reporting units which contained goodwill. The fair value of each reporting unit was determined by estimating the present value of future cash flows. Based on this test, the Company determined that goodwill in the Lottery Systems was impaired as at the date of adoption; accordingly, a transitional goodwill impairment loss of $3,422 was recognized and, pursuant to the transitional provisions of Section 3062, was charged to opening retained earnings.

3. Acquisition of Creative Games International Inc.:

On November 28, 2000, the Company purchased, through its wholly-owned subsidiary, International Security Printers, Inc., the remaining 10% of the outstanding shares of Creative Games International Inc., increasing its ownership position in the business to 100%. The acquisition has been accounted for by the purchase method. During 2001, the Company incurred additional costs in the amount of $114 related to the purchase.

Net assets acquired, at fair values:

	2002	2001
Goodwill	$ –	$ 114
Consideration given:		
Cash	$ –	$ 114

In connection with the adoption of CICA Handbook Sections 1581 and 3062, the Company has determined that contingent consideration is in substance a profit-sharing arrangement and accordingly has expensed the amount paid in 2002.

4. Accounts receivable:

	2002	2001
Trade accounts receivable	$ 21,909	$ 16,164
Allowance for doubtful accounts	(1,337)	(654)
Unbilled accounts receivable	9,953	2,898
Other	557	566
	$ 31,102	$ 18,974

5. Long-term receivables:

	2002	2001
Long-term receivables	$ 593	$ 1,001
Less current portion	101	440
	$ 492	$ 561

Included in long-term receivables are amounts due from related parties of $237 (2001 – $264).

Long-term receivables are collectible as follows: 2003 – $101; 2004 – $304; 2005 – $58; 2006 – $36; 2007 – $36; and thereafter – $58.

Uncertainty exists regarding the amounts ultimately collectible from long-term receivables denominated in foreign currencies due to foreign currency exchange rate fluctuations.

6. Property, plant and equipment:

2002	Cost	Accumulated depreciation	Net book value
Land	$ 2,175	$ –	$ 2,175
Buildings	8,553	5,796	2,757
Machinery and equipment	84,942	60,490	24,452
Leasehold improvements	2,479	1,496	983
	98,149	67,782	30,367
Property under capital lease:			
Machinery and equipment	253	74	179
	$ 98,402	$ 67,856	$ 30,546

2001	Cost	Accumulated depreciation	Net book value
Land	$ 2,631	$ –	$ 2,631
Buildings	8,539	5,531	3,008
Machinery and equipment	78,545	56,613	21,932
Leasehold improvements	2,011	1,352	659
	91,726	63,496	28,230
Property under capital lease:			
Machinery and equipment	243	–	243
	$ 91,969	$ 63,496	$ 28,473

Included in property, plant and equipment are assets in process of $4,736 (2001 – $3,442) which are not being depreciated.

During the year, property, plant and equipment was acquired at an aggregate cost of $7,624 (2001 – $5,720) of which $Nil (2001 – $243) was acquired by means of capital leases. Cash payments of $7,624 (2001 – $5,477) were made to purchase property, plant and equipment.

7. Other assets:

	2002	2001
Product development costs, net of accumulated amortization of $7,574 (2001 – $7,019)	$ 1,860	$ 1,500
Deferred start-up costs, net of accumulated amortization of $5,680 (2001 – $5,211)	4,650	1,311
Pension asset (note 11)	9,857	8,937
Future income tax asset (note 15)	2,435	4,601
Benefit of investment tax credit carry forwards	800	–
Goodwill, net of accumulated amortization of $Nil (2001 – $1,683)	–	3,422
	19,602	19,771
Less current portion of future income tax asset	1,990	–
	$ 17,612	$ 19,771

The Company has estimated the useful life of the majority of its deferred start-up costs and product development costs to be a short period based upon rapidly changing industry trends, an intense competitive environment, changing technology trends and other anticipated economic factors. Should the Company's business change, it may result in an impairment of these assets and may in turn result in an adjustment of the future carrying values by a material amount.

The recoverability of the future income tax asset is dependent on the ability of the Company to produce taxable income over fixed future periods (note 15).

8. Operating line-of-credit:

The Company has an operating line-of-credit with a major bank in the amount of $18,000. At December 28, 2002, $10,619 (2001 – $1,112) had been drawn against the facility. The line-of-credit bears interest at prime plus 0.625% per annum and is secured by a general assignment of book debts and a general security agreement.

9. Obligations under capital lease:

Future minimum capital lease payments as at December 28, 2002 and December 29, 2001 are:

	2002	2001
Year ending December 31:		
2002	$ –	64
2003	65	64
2004	65	53
2005	54	41
2006	22	51
Total minimum lease payments	206	273
Less amount representing interest (at rates ranging from 8.1% to 10.0%)	25	30
Present value of net minimum capital lease payments	181	243
Current portion of obligations under capital lease	47	47
	$ 134	196

10. Long-term debt:

	2002	2001
Prime plus 1.125%, term loan with interest payable monthly and principal payable in quarterly instalments of $397, maturing October 31, 2006	$ 5,948	$ 7,535
Prime plus 0.5%, 364-day revolving loan, repayable in quarterly instalments of $101, maturing April 15, 2003	101	506
Prime plus 0.5% repayable in quarterly instalments of $281, maturing June 30, 2003	563	1,406
6.5% mortgage on land and building, repayable in blended monthly instalments of $10 including interest to September 7, 2007	1,113	1,154
7.35% mortgage on land and building, repayable in blended monthly instalments of $5 including interest to April 23, 2004	543	566
7.1% mortgage on land and building, repayable in blended monthly instalments of $7 including interest to May 1, 2006	375	412
	8,643	11,579
Less current portion	2,351	3,210
	$ 6,292	$ 8,369

The term loan and the 364-day revolving loans are secured by a general assignment of book debts and a general security agreement.

If the 364-day revolving loans are not extended by the lender, they automatically convert to a five-year term loan.

Interest expense of $577 (2001 – $957) was incurred on the long-term debt during the year.

The aggregate maturities of long-term debt for each of the five years subsequent to December 28, 2002 are as follows: 2003 – $2,351; 2004 – $1,695; 2005 – $1,698; 2006 – $1,302; 2007 – $118; and thereafter – $1,479.

11. Employee retirement benefit obligations:

The Company has a defined benefit pension plan and a defined benefit life insurance and health care plan covering substantially all of its employees. Information about the Company's defined benefit plans is as follows:

	Pension Benefit Plan		Other Benefit Plan	
	2002	**2001**	**2002**	**2001**
Accrued benefits obligation:				
Balance, beginning of year	$ 39,980	$ 37,215	$ 11,102	$ 9,557
Employee contributions	525	743	–	–
Current service cost	424	553	309	268
Interest cost	2,446	2,464	719	687
Benefits paid	(2,307)	(2,480)	(245)	(283)
Settlements	(3,084)	–	–	–
Curtailments	(121)	–	–	–
Actuarial losses	(1,764)	1,485	(3,518)	873
Balance, end of year	36,099	39,980	8,367	11,102
Plan assets:				
Fair value, beginning of year	49,604	53,536	–	–
Actual return on plan assets	(4,677)	(2,195)	–	–
Employer contributions	(451)	–	245	283
Employee contributions	525	743	–	–
Settlements	(3,084)	–	–	–
Benefits paid	(2,307)	(2,480)	(245)	(283)
Fair value, end of year	39,610	49,604	–	–
Funded status – surplus (deficit)	3,511	9,624	(8,367)	(11,102)
Unamortized net actuarial loss (gain)	13,630	7,917	(2,645)	873
Unamortized transitional obligation (asset)	(7,284)	(8,604)	7,082	7,678
Pension asset (employee retirement benefit obligations)	$ 9,857	$ 8,937	$ (3,930)	$ (2,551)

The employee retirement benefit obligations of $5,428 (2001 – $3,285) recorded in the financial statements includes the obligation for the Other Benefit Plan of $3,930 (2001 – $2,551) and obligations for supplemental executive retirement plans of $1,498 (2001 – $734).

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows (weighted-average assumptions as of December 28):

	Pension Benefit Plan		Other Benefit Plan	
	2002	2001	2002	2001
Discount rate	6.5%	6.5%	6.75%	6.5%
Expected long-term of return on plan assets	7.5%	7.5%	7.5%	7.5%
Rate of compensation increase	2.5%	2.5%	2.5%	2.5%

The assumed health care cost trend rate at December 28, 2002 was 9% (2001 – 8%), decreasing by 1% annually to 5.5% in 2004 and thereafter.

The Company's net benefit plan expense is as follows:

	Pension Benefit Plan		Other Benefit Plan	
	2002	2001	2002	2001
Current service cost, net of employees' contributions	$ 424	$ 553	$ 309	$ 268
Interest cost	2,309	2,464	732	687
Expected return on plan assets	(3,405)	(3,950)	–	–
Amortization of transitional obligation	(1,320)	(667)	596	596
Amortization of net actuarial loss	605	–	–	–
Curtailment or settlement	(121)	–	–	–
Net benefit plans expense (income)	$ (1,508)	$ (1,600)	$ 1,637	$ 1,551

12. Financial instruments:

Risk management activities

The Company operates internationally, giving rise to significant exposure to market risks from changes in interest rates and foreign exchange rates.

Foreign exchange risk management

The Company has entered into forward foreign exchange contracts to hedge its foreign currency exposure on certain export sales. At December 28, 2002, the aggregate face value of such contracts was approximately $11,390 (2001 – $10,890).

Accounts receivable and long-term receivables at December 28, 2002 include amounts receivable in foreign currencies as follows:

	Amount due in CDN $	
	2002	2001
United States dollars	$ 9,921	$ 5,663
Belize dollars	190	406
Guyana dollars	655	696
Aruban guilder	528	467
Eastern Caribbean dollars	648	441
Euro dollars	249	312
Pounds sterling	263	288
Barbadian dollars	203	203
Honduras Lempira	563	–
Suriname guilder	202	242
Czech koruna	–	737
New Zealand dollars	–	465

Accounts payable and accrued liabilities and long-term debt at December 28, 2002 include amounts due in foreign currencies as follows:

	Amount due in CDN $	
	2002	2001
Guyana dollars	$ 2,274	$ 1,953
United States dollars	1,127	1,319
Suriname guilder	1,393	1,115
Eastern Caribbean dollars	108	148
Honduras Lempira	1,495	–

Concentrations of credit risk

The Company is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments. Credit exposure is reduced by dealing with only creditworthy counterparties or by obtaining insurance in accordance with established credit approval policies.

Concentrations of credit risk in accounts receivable and long-term receivables are indicated below by the percentage of the total balance receivable from customers in the specified geographic area.

	2002	2001
Canada	31%	45%
The Americas and Caribbean, excluding Canada	26%	26%
Europe, including Commonwealth of Independent States	11%	17%
Asia and other	32%	12%

Fair values

The carrying values of cash and cash equivalents, accounts receivable, income taxes recoverable, operating line-of-credit, accounts payable and accrued liabilities and customer deposits approximate their fair value due to the relatively short periods to maturity of the instruments. The fair values of other financial assets and liabilities included in the consolidated balance sheet are as follows:

	2002		2001	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term receivables	$ 593	$ 529	$ 1,001	$ 912
Obligations under capital lease	134	117	196	180
Prime plus 1.125% term loan, maturing October 31, 2006	5,948	5,358	7,535	6,646
Prime plus 0.5%, 364-day revolving loan, maturing April 15, 2003	101	97	506	480
Prime plus 0.5%, 364-day revolving loan, maturing June 30, 2003	563	539	1,406	1,334
6.5% mortgage, maturing September 7, 2007	1,113	881	1,154	911
7.35% mortgage, maturing April 23, 2004	543	431	566	449
7.1% mortgage, maturing May 1, 2006	375	308	412	334

Forward foreign exchange contracts which have become unfavourable to the Company since their inception have a fair value of $1.

The following methods and assumptions were used to estimate fair value of each class of financial instrument:

Long-term receivables – at the future cash flow, discounted at the year end market rate of interest being charged by the Company.

Obligations under capital leases and long-term debt – at the present value of contractual future payments of principal and interest, discounted at the current market rates of interest available to the Company for the same or similar debt instruments.

13. Share capital:

(a) Authorized and issued:

		2002	2001
Authorized:			
Unlimited	Common shares		
Unlimited	Non-voting preferred shares issuable in series		
Issued:			
24,759,900	Common shares (2001 – 24,759,900)	$ 65,453	$ 65,453

During 2001, the Company repurchased 4,000 common shares for cash consideration of $4. The average cost of the common shares repurchased was $11. The difference between the average cost and the cash received has been credited to contributed surplus.

(b) Contributed surplus:

	2002	2001
Contributed surplus, beginning of year	$ 529	$ 522
Repurchase of common shares	–	7
Contributed surplus, end of year	$ 529	$ 529

(c) Stock Option Plan:

The Company's Management Stock Option Plan is administered by the Board of Directors. Under the terms of the Plan, the Board designates management to be included under the Plan and designates the number of options and share price pursuant to the new options subject to applicable securities laws and stock exchange regulations. The aggregate number of common shares at any time available for issuance under the Plan or pursuant to other outstanding options may not exceed 10% of the common shares then issued and outstanding.

The Company has granted outstanding options to purchase 515,000 common shares at $3 per share. Of the outstanding options, 500,000 options expire February 5, 2008; the remainder expire June 25, 2008. No options were granted, exercised or forfeited in 2002.

14. Selling, general and administrative expenses:

Included in selling, general and administrative expenses are research expenses in the amount of $2,413 (2001 – $3,831), and a foreign exchange gain of $336 (2001 – $285).

15. Income taxes:

Income taxes are made up of the following components:

	2002	2001
Current income tax expense	$ 1,556	$ 2,190
Future income tax expense	2,166	–
	$ 3,722	$ 2,190

Future income taxes reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. The tax effects of temporary differences that gave rise to significant portions of the future tax asset and future tax liability are as follows:

	2002	2001
Future tax asset:		
Loss carryforwards	$ 11,948	$ 13,447
Property, plant and equipment	590	1,147
Scientific research and experimental development	1,529	1,087
Employee retirement benefit obligation	1,662	1,006
Other	457	186
Total gross future tax asset	16,186	16,873
Less valuation allowance	(9,344)	(9,062)
Net future tax asset	6,842	7,811
Future tax liability:		
Pension asset	(3,018)	(2,737)
Deferred development costs	(1,144)	(473)
Investment tax credits	(245)	–
Net future tax asset	$ 2,435	$ 4,601

Income tax expense varies from the amount that would be computed by applying the basic federal and provincial income tax rates to earnings before income taxes and amortization of goodwill, as follows:

	2002	2001
Tax rate	38.6%	42.1%
Expected Canadian income tax expense	$ 3,954	$ 2,079
Increase (decrease) resulting from:		
Change in valuation allowance	282	(198)
Non-taxable portion of gain on sale of land	(651)	–
Difference between Canadian and Foreign tax rates	(4)	225
Other	141	84
	$ 3,722	$ 2,190

The Company has non-capital losses of approximately $13,200 (2001 – $21,700) available to reduce taxable income in Canada up to 2006.

In addition, the Company has non-capital losses of $19,300 (2001 – $19,200) available to reduce taxable income in the United States up to 2020.

16. Earnings per share:

The stock options to purchase 515,000 common shares at $3 per share, as described in note 13, were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares for the reporting period.

17. Contingent liabilities:

The Company has outstanding bid and performance bonds payable primarily in US dollars, amounting to $7,879 Cdn (2001 – $4,158 Cdn).

In the ordinary course of business activities, the Company becomes involved in various legal actions. While the ultimate effect of such actions cannot be ascertained at this time, Management believes that their resolution will not have a material adverse effect on the financial position of the Company.

18. Commitments:

The Company leases certain of its office space and equipment under long-term operating leases. The required minimum lease payments under these agreements are as follows: 2003 – $2,166; 2004 – $1,998; 2005 – $1,592; 2006 – $1,261; 2007 – $1,259; and thereafter – $1,658.

As part of an acquisition of grouptheory systems, inc. in 1999, the Company has agreed to pay an amount equal to 1% of gross automated ticket sales revenues for the five year period beginning January 1, 2000.

19. Segmented information:

The Company has four reportable segments: Lottery Systems, Identification Systems, Payment Systems, and Shareholder Services. The Lottery Systems segment provides printed lottery tickets, operating lottery terminals and gaming systems. The Identification Systems segment provides production of and support system for identification documents and other security systems. The Payment Systems segment supplies high security documents and systems related thereto. The Shareholder Services segment is the printing of specialized business documents.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

2002	Lottery Systems	Identification Systems	Payment Systems	Shareholder Services	Total
Net sales	$ 25,379	$ 45,244	$ 24,043	$ 18,267	$ 112,933
Segment gross margin	8,274	19,077	6,641	7,136	41,128
Depreciation of property, plant and equipment	1,489	–	–	221	1,710
Amortization of other assets	469	342	213	–	1,024
Unallocated:					
Selling, general and administrative					27,914
Depreciation					2,984
Gain on sale of land					(3,377)
Interest expense					630
Earnings before income taxes and amortization of goodwill					$ 10,243
Segment assets	$ 22,379	$ 28,969	$ 3,067	$ 6,790	$ 61,205
Assets unallocated to segments:					
Pension asset					9,857
Shared property, plant and equipment					26,495
Future income tax asset					2,435
Benefit of investment tax credit carryforwards					800
					$ 100,792

2001	Lottery Systems	Identification Systems	Payment Systems	Shareholder Services	Total
Net sales	$ 26,549	$ 46,894	$ 26,042	$ 19,23	$ 118,718
Segment gross margin	8,058	18,784	5,692	7,066	39,600
Depreciation of property, plant and equipment	1,041	–	–	181	1,222
Amortization of other assets	718	705	306	–	1,729
Unallocated:					
Selling, general and administrative					26,150
Depreciation					4,002
Interest expense					1,558
Earnings before income taxes and amortization of goodwill					$ 4,939
Segment assets	$ 19,916	$ 20,441	$ 5,027	$ 5,248	$ 50,632
Assets unallocated to segments:					
Pension asset					8,937
Shared property, plant and equipment					24,534
Future income tax asset					4,601
Other					1,300
					$ 90,004

Revenues derived from geographical regions are as follows:

	2002	2001
Canada	$ 51,213	$ 49,140
The Americas and Caribbean, excluding Canada	34,483	33,686
Europe, including the Commonwealth of Independent States	8,947	14,734
Other	18,290	21,158
	$ 112,933	$ 118,718

Property, plant and equipment and goodwill by geographic region are as follows:

	2002	2001
Canada	$ 22,829	$ 22,688
The Americas and Caribbean, excluding Canada	7,717	9,207
	$ 30,546	$ 31,895

20. Statement of cash flow:

Interest paid during the year was $630 (2001 – $1,558). Cash flow from operations was $11,451 (2001 – $9,544) or $0.46 per share (2001 – $0. 39).

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CANADIAN BANK NOTE COMPANY, LIMITED